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SIPDIS

SENSITIVE

DEPARTMENT FOR SA/INS
DEPARTMENT PASS TO USTR - JROSENBAUM AND AWILLS
COMMERCE FOR ARI BENAISSA
MCC FOR RSANKARAN AND SGROFF

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TAGS: ECON ETRD EAID CE USTR ECONOMICS
SUBJECT: Still No GSL Economic Policy Framework, but Some Structural Reforms Anticipated

Sensitive but Unclassified, please handle accordingly.

¶1. (SBU) Summary: Recent visits by the IMF, ADB and Millennium Challenge Corporation have inspired a flurry of economic policy activity on the part of the Sri Lankan Government. It did not pull an economic plan together prior to the visits, although a Senior Advisor to the President has indicated that an initial draft plan should be out by the week of June 14. IMF representatives left without a clear sense of the direction of the GSL's economic policies and now have concerns about structural and fiscal benchmarks that had been the core of the most recent Poverty Reduction and Growth Facility (PRGF) agreement. Nonetheless, the GSL intends to launch several major reform initiatives, including three new bodies that will oversee economic reforms and state-owned enterprise restructuring. While these plans indicate a good understanding of the kinds of reforms that are needed, broad societal support and technical/professional capacity for implementation will prove to be the economic Gordian knot for the new GSL. End Summary

¶2. (U) IMF and ADB teams visited Sri Lanka the week of May 24 and a Millennium Challenge Corporation visit the week of May 31 provided an opportunity to meet with representatives from the IMF, ADB and GSL to discuss the current Government's economic policy plans.

¶3. (SBU) During a meeting between international financial institution (IFI) reps and the MCC, IMF Rep Jeremy Carter said it was clear that Sri Lanka did not have a policy yet formulated and that the GSL was in an "incredibly tough" situation, unable to match election promises and needs of coalition partners, particularly the Marxist JVP, with the requirements of international donors, who are advocating continued fiscal prudence, privatization and sectoral reforms.

¶4. (SBU) Carter thought that with the GSL's focus on the July Provincial Council elections there was little chance that any meaningful action will be taken in parliament during the next month. Therefore, economy-related legislative initiatives that were dropped when parliament was dissolved (such as new banking regulations, the foreign exchange management act, a new revenue agency), are not likely to be considered in the near term. Further, the unclear UPFA stance on privatization (there have been several contradictory statements about privatization by high-level GSL officials) has created problems for reform, particularly in state-owned banks. Meanwhile, price increases, particularly for oil, wheat flour and rice, are causing subsidy payments, or arrears, to balloon, creating pressure on the government to let prices increase.

¶5. (SBU) Until the GSL is able to articulate an economic plan and come to terms with the IMF under Article IV consultations, IMF disbursements are on hold. Carter suggested it was unlikely any disbursements could now be made before next fall, at the earliest.

¶6. (U) Senior Presidential Advisor Mano Tittawella, during a meeting with the visiting Millennium Challenge Corporation team, however, suggested that the GSL's economic plan was in the pipeline, with an initial draft to be released the week of June 14 and a final, more comprehensive strategic plan at the end of June. He expected the IMF and World Bank teams to return to discuss the country's poverty reduction strategy at that time.

¶7. (U) Tittawella said the Government's economic plan would focus on removing impediments for growth, but not through pure privatization mechanisms. He described three bodies that have been created and approved by cabinet to oversee economic reform. The first is the National Council on Economic Development, which will feature working groups from various industries. These groups will make suggestions to the Government about needed reforms. In particular, they will be asked to submit an initial list,

within a "short period of time" of actions that should be taken before the end of the year, in order to jumpstart the reform process. The idea, Tittawella said, was to convert ideas into action as quickly as possible.

¶8. (U) The second body will be the Strategic Enterprise Management Agency (SEMA), a holding company that will oversee the operations of the four state-owned banks, the port, airport, petroleum company, electricity board, bus companies, and other state-owned enterprises. SEMA will have the authority to place management at each enterprise and will be charged with implementing needed reforms to transform the companies into profitable ventures, rather than financial sinkholes.

¶9. (U) The third main body is a new National Procurement Agency that would run all large procurement projects. The GSL will ask the IFIs to provide expertise and assistance in establishing the agency. (Note: Poor government procurement procedures are the single largest source of Embassy advocacy requests. End note.)

¶10. (U) Tittawella also described the continuation of the "eSri Lanka" program begun under the last Government. This is an ambitious electronic governance plan, which, according to Tittawella, will fall under an inter-ministerial body and link up the Government's other initiatives. (Note: This project has been underway through Sri Lanka's Information and Communications Technology Agency (ICTA), with funding by the World Bank. Its structure and role under this new body remains unclear however. End note.)

¶11. (SBU) Tittawella acknowledged that the real challenge faced by the new Government was not developing new ideas, but getting them implemented. He suggested that several of the proposals, including eSri Lanka, electricity and petroleum sector reform, and the restructuring the main state bank in particular, were bi-partisan in nature and would hopefully be accomplished in fairly short order.

¶12. (SBU) Comment: The contrasting views on the economic situation posited by Carter and Tittawella make clear that the GSL has a lot on its economic plate at the moment. While the IMF is clearly not satisfied with what it sees, the focus of high-level GSL officials on continuing economic reforms is encouraging. Further, the willingness of the GSL to take a black-eye in the short-term, rather than rush out a plan that is not completely vetted, is laudable. Tittawella's admission that implementation, not conception, will be the main stumbling block, also indicates a solid understanding of the polarization of Sri Lankan society, and the poor track record of the GSL, under any administration, in actually putting reforms in place. End Comment.

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